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Wealth Management Association (WMA) response to ESAs Consultation on Guidelines on risk factors and simplified and enhanced customer due diligence

a) Do you consider that these guidelines are conducive to firms adopting risk-based, proportionate and effective AML/CFT policies and procedures in line with the requirements set out in Directive (EU) 2015/849?

WMA believes that the content of the guidance will be helpful to firms in assessing ML/TF risk and in mapping these risks with a view to create effective policies and procedures. However, how these guidelines will sit within the UK's national regulatory system remains a grey area. Art. 8(1) of the Directive requires national authorities to *take appropriate steps to identify and assess the risks of money laundering and terrorist financing, taking into account risk factors including those relating to their customers, countries or geographic areas, products, services, transactions or delivery channels*. The Directive is silent as to how this rule is to be implemented, but in practice there is likelihood that guidance will be issued, which will be applicable to firms. Art. 18(4) of the Directive requires the ESAs to *issue guidelines addressed to competent authorities and the credit institutions and financial institutions*. The ESAs guidelines therefore will apply automatically to both national authorities and firms. This overlapping of national and EU-wide guidance can cause issues when it comes to implementation, ultimately causing

[1]The Wealth Management Association (WMA) is a trade association that represents 186 wealth management firms (full members) and associate members who provide professional services to our full member firms.
WMA members firms look after over £670 billion of wealth for over 4 million retail investors.
WMA full members deal in stocks, shares and other financial instruments for individuals, trusts and charities through a range of services spanning execution only, advisory and discretionary fund management.
The WMA exists to support its members and their clients through education and engagement, advocacy and influence, research and analysis and by playing an active role as a facilitator and thought leader.
WMA firms operate across more than 580 sites, employing over 32 000 staff. These firms also run over 5.5 million client portfolios and carry out over 20 million trades a year.

confusion in both national authorities and firms. This potentially has the unwanted effect of making the guidelines unhelpful, not because of their content but because of their uncertain positioning within the UK's national regulatory system. Further guidance on how these inconsistencies in the implementation framework of the risk-based approach can be dealt with would be desirable.

b) Do you consider that these guidelines are conducive to competent authorities effectively monitoring firms' compliance with applicable AML/CFT requirements in relation to individual risk assessments and the application of both simplified and enhanced customer due diligence measures?

Please refer to our comment above in relation to the application of the guidelines to firms.

c) The guidelines in Title III of this consultation paper are organised by types of business. Respondents to this consultation paper are invited to express their views on whether such an approach gives sufficient clarity on the scope of application of the AMLD to the various entities subject to its requirements or whether it would be preferable to follow a legally-driven classification of the various sectors; for example, for the asset management sector, this would mean referring to entities covered by Directive 2009/65/EC and Directive 2011/61/EU and for the individual portfolio management or investment advice activities, or entities providing other investment services or activities, to entities covered by Directive 2014/65/EU.

WMA prefers the guidelines in Title III to be kept by types of business rather than legally driven, for the following reasons:

- A business model-based approach is more intuitive and user-friendly. It is easier and quicker to match requirements to a business model rather than to refer to legislation each time
- A firm may perform several business activities which would fall under different pieces of legislation, and having to identify each requirement out of a legally-driven directory could become problematic
- Legislation is subject to continuous evolution and amendment and there is no guarantee that a business activity that is now regulated just by one instrument will not be regulated by multiple instruments in the future: this would make the referencing even more complex.

General comment on the language of the proposed guidelines

The guidelines make large use of the words "should" and "must", but it is not really clear which is the rationale of choosing one verb over the other, over the weaker "may" (which

is also used in places), as the Directive does not go into this kind of detail. Moreover, due to the overlap of obligations explained above in our response to the consultation questions, it is unclear to what extend these guidelines are binding, and therefore how said terms should be interpreted.

Specific comments on the content of the proposed guidelines

Title I – Subject matter, scope and definitions

Para 8

Source of Funds and Source of Wealth

- "the customer's salary" is source of wealth, not source of funds
- "savings" is vague – it would be useful to have some indicative examples of what in your view falls within this category, for example "investments" or "profits from business activity".

Title II – Assessing and managing risk – general part

Para 10

Customer Due Diligence (CDD)

- The paragraph as worded implies that a firm's decision on which should be the appropriate level of CDD is to be based only upon the findings of its business-wide risk assessment. This is not the case as there are a plethora of case-specific indicators that may well need to be taken into account. In our view, therefore, the word "to decide" should be replaced with "as integral part of their decision".

Monitoring and Review

- For completeness the wording on the third line should be "source of funds and wealth"
- The sentence "they must also keep the documents, data or information they hold up to date" is excessively prescriptive and imposes impracticable requirements on firms. There is no explicit requirement in the Directive to keep CDD documents up to date, therefore the wording of the guidance should not imply this. Moreover, whilst those documents, data or information that have an expiry date (e.g. a passport) or that are available on public registries (e.g. company information) can be monitored without difficulty, there are other types of documents, data or information that do not necessarily have an expiry date, and that are not on public registers (e.g. a trust deed or a general power of attorney). With regard to this class of documents, firms have to rely on their customers, as there is no way they would be able to ascertain independently whether such documents, data or information have become obsolete. This forced reliance on third parties makes it virtually impossible for firms to comply

with the requirement as drafted. For this reason, the word "must" should be replaced by "should use best efforts to".

Identifying ML/TF risks

Para 17

- The first sentence in this paragraph is important to firms when it comes to implementation, as it confirms that ML/TF risk assessment is not and cannot be an entirely standardised exercise. We believe that this statement should be repeated in the general introduction to the guidelines.

Risk Factors – Customer risk factors

Para 19

- 1st bullet - The sectors identified as "associated with higher corruption risk" include "pharmaceuticals and healthcare". The rationale of this inclusion is unclear
- 4th bullet - The wording "purpose of their establishment" is unclear. Consider replacing with "which is the nature of the legal entity's business"
- 6th bullet – the sentence as worded is unclear, consider revising as follows: "Does the customer hold, either in addition to being a PEP or otherwise, a public position that might enable them to abuse public office for private gain (e.g. owner of a multinational company, manager of a state-owned enterprise or any other role which albeit not political per se does expose the individual to the risk of being corrupted or corrupting others)".

Para 20

- As a general comment, this section could be split into "indicia" (e.g. adverse media reports) and "evidence" (e.g. asset freezes)
- 3rd bullet – Art. 39 of the Directive contains an explicit prohibition to *disclose to the customer concerned or to other third persons the fact that information is being, will be or has been transmitted in accordance with Article 33 or 34 or that a money laundering or terrorist financing analysis is being, or may be, carried out.* SARs are confidential to the firm submitting them and only a limited amount of people within such firm would be aware of them having been submitted. Therefore, firms have no way of checking whether SARs have been submitted with regard to a perspective customer. Please delete this point as it is against a level 1 requirement.
- 4th bullet – the wording is vague and the scope of the requirement is rather wide, making it difficult to implement. It would be desirable to have further guidance on what these "suggestions" should be and where they may come from as the requirement as drafted gives no clues.

Risk Factors – Countries and geographical areas

Para 23

- 3rd bullet – the paragraph as drafted is very wide, in order to trigger a risk assessment the information should only come from official sources e.g. law enforcement (as stated) or the government. A firm would not feel confident to start an enquiry about a jurisdiction on the basis of media reports only unless these are then backed up by an official communication.

Para 24

- This paragraph deals with a specific set of requirements (EDD), yet it is positioned in within the general CDD requirements section – it should be moved to the EDD section (e.g. as a new para 47).

Risk Factors – Products, services and transactions risk factors

Para 27

- The section deals with complexity of products, however there is no distinction between those products which are complex by their own nature, for example a financial derivative, and those products which are "artificially" complex or opaque, for example some types of structured finance transactions. It would be beneficial to have a further bullet point added to reflect these circumstances.

Risk Factors – Delivery channel risk factors

Para 30

- 1st bullet – it is unclear which non-face to face CDD is to be considered reliable. This can cause implementation problems unless further guidance is provided
- 2nd bullet – Please note that when a group of companies is involved, accessing internal audit reports can become difficult, time consuming, and not always the best solution, and can result in delays which are not always justified. On these grounds, we do not believe it is appropriate to mention accessing internal audit records as an example of action that should be always taken, but rather as an exercise that should be performed only in specific cases where the outcome of the analysis of the risk factors unequivocally indicates that such records must be accessed
- 3rd bullet – how do firms assess the quality of a third party's CDD measures and how do they establish whether such third parties can be relied upon? There is no further guidance on this point, which remains vague.
- 6th bullet – how do firm assess the effectiveness of an intermediary's AML supervision?

Assessing ML/TF risk

Weighing risk factors

- As a general comment, the section could be split into “customer assessment” and “firm wide assessment”

Weighing risk factors

Para 33

- The factors to be scored should be only those that are “relevant” to the circumstances. There is no benefit in scoring all factors if they have no impact at all on the business relationship.

Para 34

- As for para 33, it should be “these relevant factors”. This is also upheld by your statement that the weight given to each factor is likely to vary depending on product/customer/firm.

Para 35

- The paragraph as worded seems to suggest an obligation on firms to operate automated risk allocation systems. This is not a requirement under the Directive. Please amend.

Para 36

- It is unclear whether this paragraph refers to those customers who have been assessed and present some level of risk or whether it refers to all clients of a firm – in our view the Directive does not impose a requirement to categorise every client, therefore we suggest amending the wording so that it reflects the fact that only those customers whose assessment evidenced an element of risk should be categorised.

Risk Management: simplified and enhanced customer due diligence

Para 39

- The first sentence refers to the application of “each” of the CDD measures, but there is no reference to a list of those measures. The second sentence does not add anything to the paragraph and can be deleted.

Simplified customer due diligence

Para 41

- Risk associated with a business relationship can never be “low” in absolute – risk is always weighted. Therefore the sentence should say “where the ML/TF risk associated with a business relationship is *identified* as low”.

Para 42

- 3rd bullet – we agree with the content of the subparagraph but in our opinion the two points should be reversed, so that the first one refers to general information gathering and the second refers to the more specific customer. We believe this flows better from a logical perspective
- Last bullet – it is impossible to comply with this requirement at the onboarding stage (when the bulk of the CDD is performed) because transaction monitoring requires a transaction history, therefore a business relationship needs to already be in place. We believe this should be specified to avoid lack of clarity.

Para 44

- The paragraph as drafted seems to suggest that SDD measures constitute risk analysis, whilst this is not the case. SDD should be applied after the risk analysis has been performed and in order to confirm that the client is low risk. Indeed, if the results of the SDD are not satisfactory, the analysis would need to be performed again and possibly a higher degree of CDD applied. Therefore, the paragraph should be amended to reflect this.

Para 48

- The references to the specific articles of the Directive are missing (they are present in the previous paragraph however). They should be added for consistency and ease of reference for the reader
- The end paragraph is unclear as drafted and can be expanded, for example by indicating that those additional measures should be taken in addition to those already taken in the situations described by this para 48 and in para 47.

<u>Politically exposed persons</u>

Para 49

- Allowing firms to categorise PEPs depending on their level of ML/TF risk is welcomed, but it is a new concept and we believe it would be beneficial to highlight this in order to bring it to firms' attention. This would help greatly in the implementation of the requirement
- The wording used to indicate a higher level of risk in the paragraph is inconsistent throughout the three bullet points (e.g. the first bullet states "degree of high risk", the second "level of increased risk" and the third "level of high risk"). This can create interpretation – and therefore implementation – problems. We suggest using the same wording throughout.

Para 50

- We suggest adding references to the articles of the Directive that contain the definitions of "family members" and "person known to be close associate", for clarity and ease of reference.

Unusual Transactions

Para 53

- In our opinion this requirement should apply to the whole client base, not just when EDD is performed

Para 54

- 2nd bullet – transaction monitoring is performed across the board and constantly – it is not clear whether the requirement refers to this general monitoring or whether there is a specific further requirement.

Para 57

- The paragraph reads an introduction to EDD therefore in our view it should be moved to the front of the EDD section
- 2nd bullet – As noted in our comment to para 44, also in this case EDD is not a risk analysis tool but a set of measures that have to be performed in order to confirm the result of the risk analysis. Therefore, the paragraph should be amended to reflect this. With regard to the list of items that can be used in order to verify source of wealth, such items are in no particular order or priority – is this intentional and it is left to each firm's own judgment to prioritise them on a case-by-case basis? If not, it would be desirable to have an indication of which factors should be prioritised.

Other considerations

Para 60

- We suggest the following addition: Firms should note that the application of a risk-based approach does not *of itself* require them to […]. The rationale for this suggested amendment is that whilst the risk-based approach does not require firms to refuse to take on clients form certain jurisdictions, there are commercial considerations and other such factors that will influence firm decisions.

Title III – Sector specific guidelines

- A general comment is that the category of "execution only" brokers is missing altogether from the sectoral guidelines. Indeed, it does not fall within the guidelines' definition of "wealth management" (*tailored services covering, for example, banking, investment management and advice, fiduciary services, safe custody, insurance, family office, tax and estate planning and associated facilities, including legal support*),

nor within the definition of "investment management" (*it includes both discretionary investment management, where investment managers take investment decisions on their customers' behalf, and advisory investment management, where investment managers advise their customers on which investments to make but do not execute transactions on the customer's behalf*). Please either amend the current guidelines to include execution only brokers in either of these pre-existing categories, or create a new section dedicated to them.

Chapter 5: sectoral guidelines for wealth management

Para 143

- Please note that most of these factors in many cases will become evident (and will be able to be scrutinised) only after the client onboarding process is finished and the business relationship has started. We believe this should be specified to avoid lack of clarity
- 7th bullet – As drafted, this sentence implies that any money or assets deposited or managed by a financial institution other than the entity performing the risk assessment – including members of the same group of companies – should be treated an indicator of higher risk. This does not make any sense, as it would make any person with a bank account a high risk customer. Therefore, as worded, the sentence is wrong and misleading. We suggest that it is amended to state that money or assets held abroad may constitute a higher risk indicator.

Para 149

- What is the rational of a blanket prohibition of SDD on customers of wealth management firms? As you have repeatedly stated throughout the guidelines, ML/TF risk assessment is a case-by-case exercise and this generalisation should not be made.

Chapter 8 – Sectoral guidelines for investment managers

Para 194

- As already pointed out in relation to wealth management, most of these factors in many cases will become evident (and will be able to be scrutinised) only after the client onboarding process is finished and the business relationship has started. We believe this should be specified to avoid lack of clarity.

Wealth Management Association